Monday, 15 September 2025

Preliminary Staff Views: NZ IFRS 16 *Leases*

This document contains preliminary staff views in response to the External Reporting Board's (XRB) request for feedback on NZ IFRS 16 *Leases*, to inform XRB's submission to the International Accounting Standard Board's Request for Information on IFRS 16 *Leases*.

These views are informed by direct outreach and consultation with stakeholders, as well as discussions held in technical and professional forums.

Overall view

Our overall view is that NZ IFRS 16 achieves its technical objective of providing relevant and faithful representation of lease transactions, with users affirming its usefulness. Despite benefits such as improved data quality and coordination, the cost and complexity of compliance are widely seen as disproportionate. There is minimal appetite for fundamental change, but strong support exists for targeted improvements, clearer guidance in judgement-heavy areas, and simplification where feasible.

New Zealand-specific matters of interest

Topic 1: Cost-benefit of ongoing compliance

- Stakeholder feedback indicates that the ongoing compliance burden of NZ IFRS 16 remains significant for many preparers, particularly among closely held large NZ companies where external users of the financial statements are limited.
- Some of these preparers apply NZ IFRS 16 adjustments only at year-end, rather than integrating them into the general ledger throughout the year, suggesting that NZ IFRS 16 has minimal benefits in an entity's day-to-day operations.
- Feedback suggests that a significant portion of the ongoing compliance costs stem from the complex systems and processes required to maintain accurate data.
- Several preparers highlighted that existing systems are not fully equipped to handle the intricacies of NZ IFRS 16, leading to reliance on manual spreadsheets and controls, which increases the risk of error and compliance costs.
- Some entities report that the complexity of NZ IFRS 16 necessitates dedicated full-time staff. Alternatively, some entities engage external consultants to manage lease accounting on their behalf. While this can address internal capability gaps, it often comes at a considerable additional cost.

- Auditors have noted that lease accounting consumes a substantial portion of audit effort. This is often due to preparer misinterpretation or misapplication of the standard, resulting in frequent adjustments and increased audit scrutiny.
- Most users believe that NZ IFRS 16 results in relevant information that faithfully represents lease transactions, agreeing that leases should be treated as debt-like obligations. However, some will "back out" or request pre-NZ IFRS 16 figures for certain purposes (see Topic 5).

Topic 2: Discount rates

- When surveyed in our IFRS 16 roundtables, participants unanimously reported using the incremental borrowing rate (IBR) rather than the interest rate implicit in the lease (IRIL).
- The main reason provided was that the IRIL could not be readily determined in many of their leases, notably that information about the lessor's direct costs was not available, necessitating the use of IBR under NZ IFRS 16.26. Some respondents indicated that the IBR is readily available, whereas the IRIL requires calculation and therefore adds further complexity to an already resource-intensive standard.
- It was also noted that determining an accurate IBR can be particularly challenging for entities with little or no borrowing history upon which to base their determinations. Benchmarking against other entities can be similarly difficult due to limited reliable publicly available data, or unique operations making direct comparisons impractical.
- Despite the above point, we heard from several preparers and auditors that it is generally accepted that the IBR determined may not be entirely accurate but consider the impact immaterial.
- Stakeholders indicated that simplified principles and clearer guidance would be welcomed, including illustrative methodologies for estimating IBR in the absence of direct borrowing data, and guidance on acceptable proxies such as government bond rates or commercial lending rates, where appropriate. In addition, the XRB could consider whether relief could be provided to permit the use of a bank borrowing rate in circumstances where an entity is unable to reliably determine an IBR.

Topic 3: Long-term property leases

- Under NZ IFRS 16, lease liabilities are measured in a way that results in interest being recognised over time, even though lease payments are not interest-bearing. In very long-term leases with low initial payments, this can lead to interest expense exceeding repayments in early years, which may be misinterpreted by users as a failure to meet obligations. For transparency, there could be an optional disclosure clarifying that interest is not payable on the lease and the amount is to reflect the time value of money.

Topic 4: Disclosure practices and comparability

- As lessees prepare disclosures to meet the needs of their users, some variation is permitted under NZ IFRS 16, which allows flexibility in how the disclosure objective in paragraph 51 is achieved.
- Closely held NZ companies may provide more summarised or tailored lease disclosures, as key users including private shareholders and directors typically receive detailed financial information through internal management reports and board meetings. This can reduce comparability with those reporting to public shareholders.
- We heard from several stakeholders that preparing detailed disclosures is one of the more resource intensive practices when applying NZ IFRS 16. Entities with limited finance teams or technical expertise may opt for more streamlined disclosures, where suitable for users' needs, to manage workload.
- While NZ IFRS 16 requires disclosure of excluded variable lease payments, the usefulness of this information depends on how clearly and consistently it is presented. Some stakeholders suggested introducing clearer criteria to distinguish between truly variable payments and in-substance fixed payments.
- Some investors expressed that disclosure of non-cash movements would make it easier to compare cash flow statements across entities. This would be of particular use for assessing debt-like obligations and understanding the true cash impact of leases. However, we acknowledge that it is challenging to balance the need for detailed disclosures that support user analysis with the risk of overwhelming financial statements and obscuring material information, as cautioned in NZ IFRS 16.7(e).
- Users such as analysts, investors and lenders expressed that the maturity analysis disclosure in NZ IFRS 16.58 is particularly valuable as it provides forecasted lease payments, which is critical for assessing loan serviceability and cash flow.
- Certain users suggested that disclosing the useful life of leased assets would improve comparability by providing a clearer indication of the period over which the asset is expected to generate value irrespective of differences in lease structuring across entities.

Topic 5: User adjustments to reported figures

- Despite the goal of NZ IFRS 16 to improve transparency and comparability, we have heard that analysts and professional investors often request pre-NZ IFRS 16 data, or adjust figures to remove the standard's effect, believing this gives a fairer view of an entity's performance and liquidity.
- Common reasoning is that certain metrics are skewed by the application of NZ IFRS 16. This includes generalised metrics such as Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA), Return on Assets (ROU) and various debt

ratio calculations, and extends to sector-specific metrics. For instance, Net Operating Income in the real estate industry is often adjusted for the capitalisation of leases.

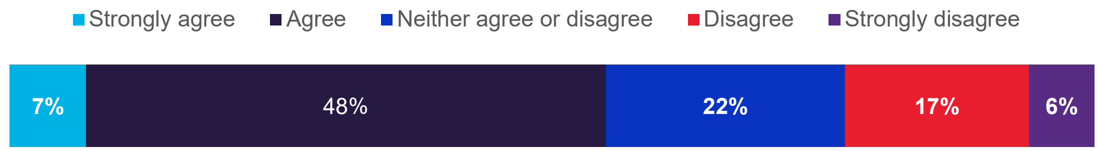
- Internal management reporting or performance measures often apply a cash-based view, reinforcing our point in Topic 1 that NZ IFRS 16 offers limited practical benefits for entities in their day-to-day operations. In many cases, it appears the standard adds complexity without delivering meaningful improvements for preparers or users.
- We acknowledge that users have diverse information needs, and it is not realistic to expect a single accounting standard to meet all of them. On balance, stakeholders advised that NZ IFRS 16 improves the quality and completeness of financial information. Historically, users often removed finance leases from analyses, complicated by differing lease classifications. NZ IFRS 16 has streamlined this by requiring a consistent approach for all leases.
- Suggestions for additional disclosures that may support specific user needs are outlined in our final point under Topic 4.

IASB Request for Information

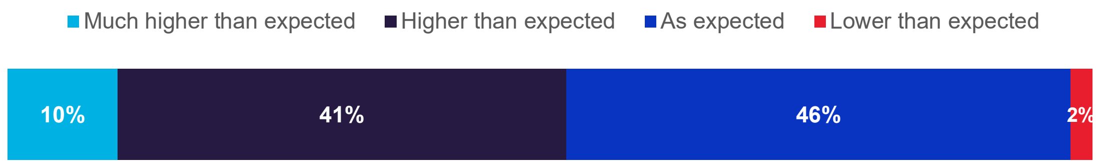
Question 1: Overall assessment of IFRS 16

- Many stakeholders agreed that IFRS 16 meets its technical objective of providing relevant information that faithfully represents lease transactions.
- While IFRS 16 provides a more comprehensive view of lease obligations than IAS 17, several preparers and users indicated that pre-IFRS 16 figures better reflect an entity's cash position and are therefore preferred for internal decision-making, performance monitoring, and external financing and valuation considerations.
- The indirect benefit of IFRS 16 leading to improvements in data quality and interdepartmental coordination have been acknowledged, but many stakeholders believe the cost of compliance remains disproportionate to the benefits.
- While there is a minimal appetite for fundamental change due to potential disruption, stakeholders support clarification of requirements, additional guidance in judgement-rich areas, and simplification where possible.
- In a poll of over 900 Chartered Accountants at a July 2025 webinar, we gathered targeted insights on the implementation and impact of IFRS 16. The following tables summarise the member responses:

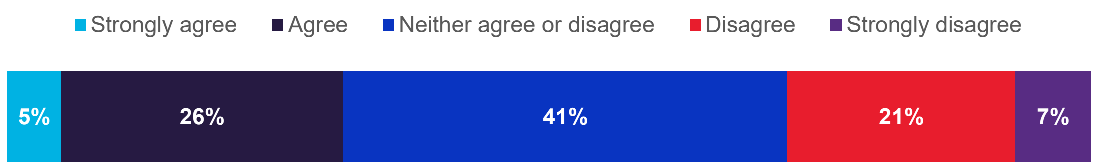
Do you agree that bringing all leases on the balance sheet has improved the quality and comparability of financial statements?



How would you rate the ongoing cost of applying* IFRS 16 Leases *compared to expectations?



Do you believe the benefits of* IFRS 16 Leases *exceed the costs?



Question 2: Lessees' application of judgement

- Broadly, stakeholders agreed that lessees' application of judgement reduces comparability across entities, thereby reducing the usefulness of the financial information. In addition, the complexity increases preparation and audit costs.
- Areas of specific concern include determination of lease term, discount rates, variable lease payments, and the distinction between reassessment versus modifications.
- **Lease term:** Significant ambiguity exists around assessing the "reasonably certain" threshold for determining lease term, especially in the context of incentives, extension options, and informal or undocumented arrangements. Clearer guidance and illustrative examples are needed to support consistent interpretation.
- **Discount rates:** Many preparers default to using their incremental borrowing rate (IBR) to calculate the discount rate as the information required to calculate the interest rate implicit in the lease is not as readily available. Reference benchmarks or simplified methodologies would assist smaller entities.

- **Variable lease payments:** Payments that appear variable but are economically unavoidable require nuanced interpretation and are often inconsistently applied. While IFRS 16 requires disclosure of excluded variable lease payments, the usefulness of this information depends on how clearly and consistently it is presented. It was suggested to introduce clearer criteria to distinguish between truly variable payments and in-substance fixed payments, particularly for market rent reviews and CPI-linked adjustments.
- **Reassessment or modification:** The distinction is complex, often unclear in practice, and may be unnecessarily burdensome. Stakeholders have called for explicit criteria or decision trees to guide the determination.

Question 3: Cash flow

- Users have indicated a preference for presenting the principal and interest components of lease payments within the same category in the cash flow statement. While IAS 7.31 does not specify a classification for interest paid, grouping the components may improve understandability of the complete transaction.
- Some stakeholders feel the current cash flow presentation of principal payments under financing activities does not always align with the entity's business operations (especially in industries like retail and telecoms). It was suggested that flexibility is permitted in the classification of such lease-related cash flows, possibly drawing on the concept in IFRS 18.50 allowing entities with specified main business activities to classify certain income and expenses in the operating category, even if they would otherwise be classified as investing or financing.
- Classification as financing activities has made it more complex for certain key users (banks, investors, valuers) to compare entities, leading to requests for pre-IFRS 16 adjusted figures.
- We recommend that lease-related cash flows be explored further as part of the IASB's Statement of Cash Flows and Related Matters project.

Question 4: Ongoing costs

- The IASB anticipated that ongoing costs would be little more than IAS 17 depending on the entity's software (i.e., whether the entity could extend its existing software, or if they needed to migrate to a new system, either entirely or just for lease accounting) and number of leases. Many stakeholders advised that they continue to incur high ongoing costs and see limited benefits.
- Specialist software, outsourcing, or dedicated lease accounting staff are often required to manage the complexity of lease accounting, all of which are costly.
- Main drivers of ongoing costs include initial and subsequent measurement, collection of disclosure information, and determination of discount rate and lease term.

- IFRS 16 issues contribute to a large portion of audit time and cost, with many queries and findings arising from misunderstanding of principals or application of judgment.
- Annual CPI-based lease liability adjustments are operationally burdensome; the US GAAP approach, which does not require remeasurement unless the lease is modified, is more practical.

Question 5: Transition requirements

- The first year of reporting under IFRS 16 was particularly challenging due to the volume and complexity of data required, especially for entities with large lease portfolios.
- The practical expedients and exemptions, such as for low-value and short-term leases, significantly assisted in reducing the implementation burden both during the initial transition and ongoing compliance.
- Transition guidance or instructions issued by the IASB, well before the standard was effective, would have been helpful to assist preparers collect new data, and update systems and processes.
- Several stakeholders noted that specialised software solutions were not available in time for the standard's effective date. As a result, some entities had to adopt a two-phased implementation approach and initially rely on manual workarounds or interim systems before transitioning to purpose-built software once available. A longer lead time may have enabled providers to develop and release appropriate tools prior to the effective date, easing the transition burden.

Question 6.1: Rent concessions

- The specific scenario in Spotlight 6.1 is not common amongst those consulted.
- Broadly, it was agreed there is a lack of guidance on distinguishing between a lease modification as defined in IFRS 16 and an extinguishment (or partial extinguishment) of a lease liability accounted for in accordance with IFRS 9.
- We support the IFRS Interpretations Committee's recommendation for the IASB to conduct a narrow-scope standard-setting project to clarify this distinction.

Question 6.2 & 6.3: Sale and leaseback transactions

- Stakeholders confirmed it is difficult to determine whether the transfer of an asset by the seller-lessee in a sale and leaseback transaction is a sale in accordance with IFRS 15. Additional illustrative examples or decision trees may assist in determining whether a sale has occurred.
- Restricting the gain or loss an entity recognises in a sale and leaseback transaction was broadly supported.